Two-Sided Markets: Competition Law in Europe

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TWO-SIDED MARKETS HAVE BEEN the subject of economic commentary for more than three decades but have recently been under the legal spotlight in the wake of the U.S. Supreme Court’s decision in Ohio v. American Express Co.1 The Court ruled that two-sided simultaneous transaction markets constitute a single market, and a restraint in a market must be evaluated by considering and setting out its effects on both sides of the market.

Although the debate around the definition of two-sided markets is not settled, we can generally speak of a market as being two-sided if a business acts as a platform and sells two different products or services to two groups of consumers, while recognizing that the demand from one group of customers depends upon the demand from the other group and/or vice versa (indirect network effect(s)).2

Courts in Europe—both at the European Union and domestic levels—have likewise addressed two-sided markets. In this article we examine the law on two-sided markets as it has evolved at the EU level, including the European Court of Justice (CJ), the General Court (GC), and the European Commission3 (together, the EU Institutions), and also in England and Wales4 (England).

Restriction of Competition—by Object or Effect?

Article 1015 forms the basis of competition law in the EU, which has been harmonized across EU Member States such that it also forms the basis of domestic competition law. Article 101(1) prohibits agreements between undertakings which affect trade between Member States that have, as their “object” or “effect,” the prevention, restriction, or distortion of competition (comparable to an unlawful agreement under Section 1 of the Sherman Act in the United States). Once the form of collusion is established, it is necessary to determine whether the coordination between undertakings restricts competition by object or by effect. A potential exemption from an Article 101(1) infringement is then possible (and is discussed further below), similar to a rule of reason evaluation in the United States.

The CJ’s analysis in Groupement des Cartes Bancaires6 (GCB) focused upon the distinction between a by object and by effect infringement. GCB was an interest group of banks, established under French law, the objective of which was to achieve inter-operability of the payment and withdrawal card systems between its member banks. The Commission’s decision, confirmed by the GC,7 found that GCB infringed Article 101 “by object” by adopting pricing measures that applied to all members and precluded the issuing of cards by other banks at a lower price than the price the large banks were offering.8 The CJ restricted the scope of “by object” restrictions to conduct that reveals in itself a “sufficient degree of harm to competition.”9 The CJ therefore held that all relevant aspects—such as the real conditions and functioning of the market—must be taken into account when determining whether the competition is restricted by object.10 The threshold test set by the CJ in GCB is that the object infringement must be “obvious” and to a degree that an analysis of a restrictive effect of the conduct would be considered redundant.11

Regarding practices with an effect on both sides of the markets, the coordination between the undertakings may produce network effects (i.e., the context in which goods/services offer increasing benefits/creates greater value the more users it has, e.g., the extent of a merchant’s acceptance of cards as against the number of cards in circulation). In this case, the CJ held that the finding of an infringement by object cannot be made. GCB argued that a purpose for its pricing measures was to establish a certain ratio between the two sides of the payment market by imposing a financial contribution on some of the group members.12 The CJ accepted this argument, crediting the fact that GCB pursued a legitimate purpose as an alternative objective, which had to be taken into consideration and could not be dismissed as irrelevant.13 The CJ further held that, even though a by object infringement cannot be harmful to competition by its nature, practices could hinder competition to a certain degree and should be assessed in the second-stage analysis of an effect restriction.14

GCB therefore shows that businesses which seek to facilitate the interaction between parties on different sides of a two-sided market for a fee will often produce direct and indirect network effects on both sides of the market. Consequently, when considering a restriction on competition on a two-sided market, it is necessary to consider both the direct and indirect effects on the market.

Exemption Under Article 101(3) TFEU

Article 101(3) provides a legal exemption from Article 101(1) when certain conditions are cumulatively satisfied.15 This

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exemption was considered by the CJ and GC in the context of MasterCard’s payment system in the European Economic Area (EEA), and also more recently by the English Court of Appeal in what is perhaps the most significant decision concerning the application of competition law to two-sided markets at the time of writing. In considering the lawfulness of MasterCard’s and VISA’s multilateral interchange fees (MIFs), the Court of Appeal provided guidance on how the test under Article 101(3) should be applied in the case of a two-sided market.

Introduction to the Dispute

MasterCard and VISA operate a four-party payment card scheme, in which merchants pay the MIF to their bank (the Acquiring Bank) as part of the “Merchant Service Charge” when customers use a debit or credit card issued by their respective bank (the Issuing Bank) to pay for goods or services.

The MasterCard and VISA schemes are two-sided in nature as the Issuing Banks compete for the business of cardholders and the Acquiring Banks compete for the business of merchants. Those two sides of the platform are closely linked because: (1) the value of a MasterCard or VISA-branded debit or credit card to a cardholder depends upon the extent to which it will be accepted by merchants; and (2) the benefit that merchants gain from accepting MasterCard or VISA-branded debit or credit cards depends upon the extent to which cardholders possess and use those cards. This is indicative of the network externalities approach, as it is necessary for the schemes to attract merchants and cardholders alike.

The Interchange Fee Regulation, which came into force across EU Member States in December 2015, established a more level playing field by capping debit and credit card MIFs for cross-border and domestic consumer card transactions in the EEA. Prior to being regulated, the issue was whether the application of a MIF was a concerted practice in breach of EU competition law.

The Regulatory Background—The Approach of the EU Institutions

MasterCard’s and VISA’s MIFs have attracted attention from both national and international competition regulators for decades up to the present day. In 2002, 2010, and 2014, the Commission accepted commitments from VISA in relation to its EEA MIFs. Regarding MasterCard, in December 2007 the Commission issued an infringement decision in relation to its cross-border MIFs in the EEA, finding that they were unlawful in the period dating back to May 1992 (the 2007 Decision).

In assessing the effect of the imposition of MIFs on competition, the Commission rejected MasterCard’s initial characterisation of its scheme being a single payment systems market between Acquiring and Issuing Banks. Both the GC and CJ subsequently rejected MasterCard’s attempt to appeal the 2007 Decision, upholding the finding of infringement under Article 101(1) and determining that MasterCard had not provided any justification sufficient to warrant an exemption of the infringement under Article 101(3).

In those CJ and GC appeals, MasterCard argued that there were several advantages derived from the MIFs which should have led to an exemption under Article 101(3), specifically taking into account the two-sided nature of the scheme. These were, according to MasterCard, not only the balancing of the acquiring and the issuing-sides of the market with the benefits to merchants, which the GC had considered, but also the objective advantages appreciable on the cardholder market (such as incentives that may be offered by the cardholder’s Issuing Bank).

Throughout the appeals, MasterCard sought to persuade the courts that the effect of the EEA MIF was outweighed by the efficiencies created by lower cardholder fees. Although the 2007 Decision noted that the MIFs were capable of generating such efficiencies, MasterCard—as the GC observed—failed to submit the required empirical evidence to demonstrate any positive effects on innovation to establish a fair share to the merchants, one of the requirements for exemption from the prohibitions of Article 101(1). The GC wrote that,

Thus, absent MasterCard having demonstrated advantages to merchants, it was not necessary for the Commission to consider whether any such advantages also were of benefit to cardholders.

The CJ also held that that the two-sided nature of a market must be considered as part of the economic and legal arguments in the Article 101(1) analysis, and that the relevant counterfactual (similar to the United States “but for” world) should be guided by all sides of the market being affected by the potential restriction on competition. In considering the application of Article 101(3), the CJ noted that within the assessment of Article 101(3):

[It]he appreciable objective advantages to which the first condition of [Art. 101(3)] relates may not arise only for the relevant market but also for every other market on which the agreement in question might have beneficial effects . . . as merchants constitute one of the two groups of users affected by payment cards, the very existence of the second condition of Art. 101(3) necessarily means that the existence of appreciable objective advantages attributable to the MIF must also be established in regard to them.

The guidelines set down by the Commission on the application of Article 101(3) require that where more than one market is affected, efficiencies are only relevant if consumers...
on both markets are substantially the same.\textsuperscript{31} This was not the case here as the two different groups were the cardholders and the merchants—and therefore the restriction on competition must create a fair share of the benefits for both cardholders and merchants alike. The CJ previously determined that this involved a consideration of whether there are net benefits to both groups as consumers as a whole, as well as whether there were net benefits to merchants as the consumer affected by the restriction on competition.

Assessment of UK MIFs Before the English Courts
Following the 2007 Decision, claims were issued by UK retailers in the English courts against MasterCard and VISA, comprising both follow-on damages claims for the MasterCard EEA fall-back MIFs\textsuperscript{32} and stand-alone claims in relation to UK MIFs.\textsuperscript{33} The UK MIF claims were brought on the basis that the principles of the 2007 Decision, in which EEA fall-back MIFs had been found to be unlawful, could be “read across” as applying equally to domestic UK MIFs. The key issues before the courts were: (1) whether the MIF was a restriction of competition law under Article 101(1); and (2) if so, whether MasterCard and VISA could justify that the MIFs were exempt under Article 101(3) since the restrictive MIF provides benefits that ultimately outweigh the restrictive effect.\textsuperscript{34}

These issues were considered by the lower courts in three separate proceedings: (1) in the Competition Appeal Tribunal (CAT) in a claim brought by Sainsbury’s, one of the largest supermarket retailers in the UK, against MasterCard; (2) in the Commercial Division of the High Court in claims by ASDA, another one of the largest supermarket retailers in the UK, and others against MasterCard; and (3) in joined claims by Sainsbury’s, ASDA, and others against VISA in the High Court. All three Judgments reached different conclusions on very similar facts, illustrating the difficulties in assessing two-sided markets and the test to be applied in considering whether restrictions could be justified, leading to all three proceedings being combined in joint-appeal proceedings before the Court of Appeal.

The CAT Claim: Sainsbury’s v. MasterCard
The CAT identified three relevant markets that were affected by the MIF: the acquiring market (where banks compete for retailers), the issuing market (where banks compete to provide services to customer account holders), and the payment systems market (where MasterCard competes with VISA).\textsuperscript{35} The CAT held that the most adversely affected market was that of the acquirers, and concluded that the UK MIF was a restriction of competition by effect, albeit on the basis of a different counterfactual used by the Commission. Specifically, the CAT found that, in a counterfactual world, bilateral agreements would have been entered into by the Issuing and Acquiring Banks. Neither Sainsbury’s nor MasterCard had submitted evidence on bilateral agreements being the appropriate counterfactual. As to Article 101(3), the CAT held that the UK MIF did not satisfy the exemption criteria on the basis that the evidence before it had failed to demonstrate any possible exemption.

The First High Court Claim: ASDA and Others v. MasterCard
Taking a different approach, the High Court in the ASDA claim against MasterCard held that it was not bound to follow either the CAT’s judgment or the Commission’s approach in its 2007 Decision (given that the Decision focused upon EEA MIFs and not UK MIFs, and that the Decision also covered a different time period to that claimed by the UK retailers). The High Court alternatively held that the acquiring market was the only affected market, opting to instead apply the analysis of the GC in \textit{GCB}. (Notably the \textit{GCB} GC decision was not raised before the CAT.\textsuperscript{36}) Whereas the CAT held that the MIFs were not objectively necessary, the High Court was persuaded by MasterCard’s “death spiral” argument to justify the existence of the MIFs as being objectively necessary for the scheme to operate.

The “death spiral” argument is based upon the theory that where one payment system’s scheme is forced to lower its MIFs while its rival scheme continues to set high MIFs, the scheme with lower MIFs loses most or all of its Issuing Banks to its rival. This is despite the fact that MasterCard had previously sought to claim before the GC that it “would have preferred to let its system collapse rather than adopt the other solution.”\textsuperscript{37}

As to its assessment on Article 101(3), the High Court found that the MIF maximizes efficiencies and that consumers are better off as a result of the MIF. In the final blow to the CAT’s decision, the High Court found that the MIFs would have been exempt at higher levels than were actually set by MasterCard.

The Second High Court Claim: Sainsbury’s, ASDA, and Others v. VISA
In a further contrasting judgment, the High Court in claims brought against VISA also found in favor of VISA, holding that no restriction of competition existed, basing its conclusion on different reasons than in the MasterCard case before the High Court.\textsuperscript{38} The High Court determined that it was free to reach an alternative conclusion as to the lawfulness of the MIFs to that reached by the Commission on the basis that it was ruling on UK MIFs, which were not the subject of the 2007 Decision. In a further twist, the High Court found that even if the MIFs had constituted an infringement on competition, they would not have been exempt at any level on the basis of Article 101(3) because the evidence before it failed to demonstrate any benefits to consumers.\textsuperscript{39}

The Court of Appeal Judgment
As the lower courts had granted permission to appeal in all three cases, the Court of Appeal joined the appeals into one set of appeal proceedings for case-management reasons and
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to avoid any further conflicting court judgments. The Court of Appeal found that the setting by MasterCard and VISA of a default UK MIF constituted a restriction on competition when compared to a world without the default MIF, where there is, instead, settlement at par (i.e., the Issuing Bank is to pay the Acquiring Bank 100 percent of the transaction, without first deducting the MIF). In doing so, the Court of Appeal found that it was not necessary to consider the twosidedness of the market in an assessment of whether the alleged conduct constitutes a restriction of competition in view of Article 101(1); instead, the twosidedness of the market comes into play when assessing if the scheme can demonstrate that the restriction is “objectively necessary” for the scheme to survive.

The Court of Appeal declined to make a substantive finding on whether the MIFs were justified in whole or in part under Article 101(3). Instead, the Court of Appeal laid down the principles which should be applied and, thus, remitted all three appealed cases back to the CAT for application of those principles to the evidence put forward at the original trials. Before the remittal hearing was listed, permission to appeal was granted to MasterCard/VISA by the UK Supreme Court in November 2018. An appeal hearing has been set for January 2020, so it may not be until Spring 2020 that the fate of the Court of Appeal Judgment is finally known.

The key implications for two-sided markets lay in the Court of Appeal’s assessment of Article 101(3). Part of that guidance requires that there must be a direct link between the restriction on competition and the resulting benefits to each side of the market, which must be underpinned by facts and evidence that are supported by empirical analysis and data. This effectively prevents MasterCard and VISA from relying upon economic opinion alone, as both schemes will now be required to demonstrate, through concrete empirical evidence, that the restriction nevertheless does give rise to benefits in accordance with Article 101(3), therefore setting a high bar.

Additionally, a fair share of the benefit must be felt by consumers. In this regard, the benefits need not necessarily be shared equally, but rather, the market subject to the restriction must be no worse-off than if the restriction were not in place. This means that any resulting benefits to cardholders cannot override the resulting detriment to merchants, thereby requiring a holistic analysis of the effect of the restriction. This finding is aligned with the CJ’s conclusion in the MasterCard appeal, which held that where restrictive effects have been found on only one market of a two-sided system, the advantages flowing from the restrictive measure on a separate but connected market also associated with that system cannot, in themselves, be of such a character as to compensate for the disadvantages resulting from that measure in the absence of any proof of the existence of appreciable objective advantages attributable to that measure in the relevant market, in particular ... where the consumers on those markets are not substantially the same.

Further, the schemes are faced with the burden of proof, which must include empirical evidence showing that the MIFs caused Issuing Banks to increase cardholder benefits, resulting in a benefit to merchants (or that the merchants were not worse-off absent the default MIF), in order to satisfy the CAT.

Pending review by the UK Supreme Court, the Court of Appeal’s Judgment firmly establishes that a restriction on one side of the market is incapable of being offset by efficiencies on the other side of the market and, in this case, that a misbalancing of the efficiencies across both sides of the market is not capable of alleviating a restriction of competition.

Article 102 TFEU—Google Android

Unlike under Article 101, which assesses anticompetitive agreements, Article 102 prohibits the unilateral conduct of a dominant undertaking in an abusive manner. The most recent development regarding Article 102 in the context of two-sided markets is the Commission’s case against Google with respect to its Android software licensing practices, in which Google argued that the Commission had to consider a two-sided market analysis when assessing whether a violation had occurred.

Abuse of a Dominant Position. Since 2011, Google put in place tight contractual restrictions on Android device manufacturers and mobile network operators, which contributed to Google’s leading position in the internet search market. In its review of the market, the Commission confirmed Google’s dominance in three markets: general internet search services, licensable smart mobile operating systems, and app stores for the Android system. Although having a dominant position is not a violation, the Commission found that Google was abusing its dominant position in several practices, namely, through its insistence that all mobile phone-makers wanting to install Google Play Store had to also pre-install Google’s search app and Google Chrome in order to gain licensed access to Google Play. Due to Google’s dominant position, mobile phone-makers had little choice but to comply with the conditions of pre-installing Google’s search app and Chrome.
The Commission’s Tying Test. Of the many interesting aspects the Google Android decision covers, the Commission’s considerations on the tying test are the most relevant with respect to two-sided markets. This part of the decision relates to Google’s contractual tying arrangement requiring the pre-installation of Google’s search app and Chrome in order to install its Play Store. Google raised the same defense brought in the recent U.S. American Express case—that not just one side of the market (the search engine market and the browser market) should be taken into consideration. Rather, the broader benefits which take effect on the other side of the market (the operating systems and app store markets) must be factored into the assessment.

As part of an objective justification analysis, the Commission assessed whether the specific restrictions at issue were associated with Google to prove that its tying practice was underpinned by facts and evidence supported by empirical aspects the Google Android decision covers, the Commission, Google did not succeed in demonstrating that the restriction was indispensable:

Google achieves billions of dollars in annual revenues with the Google Play Store alone, it collects a lot of data that is valuable to Google’s search and advertising business from Android devices, and it would still have benefited from a significant stream of revenue from search advertising without the restriction.45

Conclusion
Applying EU competition law provisions to two-sided markets requires an alternative assessment compared to cases with only a one-sided relevant market. In particular, the exemption criteria pursuant to Article 101(3) requires both the European courts and national courts in the Member States to ensure a balancing of benefits (despite a restriction of competition) in all of the affected markets, as confirmed by the CJ in MasterCard.46 The Court of Appeal has further clarified that the causal nexus between the restriction and the benefits must be underpinned by facts and evidence supported by empirical analysis and data. With the burden of proof being on the defendant, this sets a high bar although it remains to be seen how this will ultimately be applied by the CAT.

2 OECD, Note by Dr. L. Filistrucchi, Directorate for Financial and Enterprise Affairs Competition Committee, Market Definition in Multi-Sided Markets, DAF/COMP/WD(2017)27/FINAL ¶ 2 (June 2017).
3 The Commission, CJ, and GC together address the interpretation and application of EU law, which applies to EU Member States.
4 References to “England,” “English,” and the “English courts” are to be construed as references to England and Wales.
10 Id. ¶ 78.
15 These conditions are: (1) The agreement, decision, or concerted practices must contribute to improving the production or distribution of goods or to promoting technical or economic progress; (2) consumers must receive a fair share of the benefit; (3) the restrictions are indispensable to the attainment of these objectives; and (4) competition is not eliminated with respect to a substantial part of the products in question.
16 The EEA includes EU Member States, in addition to Iceland, Liechtenstein, and Norway.
17 Sainsbury’s Supermarkets Ltd & Ors v. Mastercard Inc. & Ors [2018] EWCA 1536 (Civ) (July 4, 2018).
18 This is also known as a “network effect,” i.e., the effect that an additional user of goods or services has on the value of that good or service to others. Positive network externalities exist, provided that the benefits are a common function determining the number of other users on the platform.
20 In December 2018, the Commission invited third parties to make written observations regarding commitments proposed by MasterCard and VISA for its inter-regional MIFs. Furthermore, the Commission announced its finding of an infringement by MasterCard in relation to its central acquiring rule in January 2019.
25 Id. ¶ 229.
26 These are the increase in the number of cards in circulation, which may increase the utility of the MasterCard system for merchants. However, the GC concluded that the risk of adverse effects for merchants is higher the greater the number of cards in circulation; see id. ¶ 239. The GC therefore did not find any advantages enjoyed by the merchants flowing from the MIFs. See id. ¶ 243.
28 Of interest, the U.S. Supreme Court made clear in Ohio v. American Express Co. that both sides of the two-sided market had to be considered in the
Court’s analysis regarding the claim under Section 1 of the Sherman Act. However, in the United States, the burden of proof with respect to cardholder benefits was placed on the governmental plaintiffs. 138 S. Ct. at 2284–88. According to the Court, the governmental plaintiffs failed to meet that burden because they focused their argument only on the merchant side of the market. Id. at 2287. On the other hand, in England, the Court of Appeal properly placed the obligation of proof on MasterCard, which failed to meet its burden.

30 Id. ¶ 237.
32 Relying upon the 2007 Decision as establishing the liability of the infringement. The EEA fall-back MIFs apply: (1) to all cross-border transactions between Member States; and (2) where Acquiring and Issuing Banks have been unable to agree, between themselves, a “bilateral” fee or in the absence of a domestic fee set by MasterCard or VISA.
33 Requiring the claimants to establish all elements of a damages action.
35 Sainsbury’s Supermarkets Ltd v. MasterCard Inc. [2016] CAT 2 (Feb. 9, 2016).
40 This counterfactual is the same as that adopted by the Commission, and ultimately supported by the CJ. As such, the right test in determining the appropriate counterfactual is to ask whether the default MIF was essential to the survival of the scheme—to which it found the answer to be in the negative (therefore a rejection of the “death spiral” argument, which the Court of Appeal held should not have been considered as part of the Article 101(1) analysis but rather should have formed a part of the Article 101(3) analysis).
41 Sainsbury’s Supermarkets Ltd & Ors v. MasterCard Inc. & Ors [2018] EWCA 1536 (Civ) (July 4, 2018), ¶ 162.
42 Id. ¶¶ 84–108.
44 American Express, 138 S. Ct. 2274.